Supreme Court Adopts Nerve Center Test for Corporate Citizenship

By John Sear

"[W]e conclude that the phrase 'principal place of business' refers to the place where the corporation's high level officers direct, control, and coordinate the corporation's activities," Justice Breyer wrote earlier this year for the unanimous Supreme Court in *Hertz Corp. v. Friend*, 559 U.S. ___, 130 S. Ct. 1181, 1186 (2010), to resolve the conflict among the Circuits about how to determine a corporation's citizenship for purposes of federal diversity jurisdiction under 28 U.S.C. § 1332.In adopting the "nerve center" test for determining corporate citizenship, the Court in *Hertz Corp.* rejected the far more complex "business activities" approach that attempts to determine citizenship based upon the volume of business a corporation carried on within a particular state. The "nerve center" approach, according to the Court, is superior to other approaches because it comports with the language and legislative history of § 1332 and promotes administrative simplicity and economy.

Facts

The plaintiffs in *Hertz Corp.* filed a class action in California state court, claiming that Hertz violated California's wage and hour laws. Hertz removed the case, invoking the federal court's diversity of citizenship jurisdiction under § 1332. When the plaintiffs moved to remand, Hertz filed a declaration of one of its employees spelling out Hertz's business connections to California compared with other states, including the number of rental car locations in California (273 of 1,606 total locations), the amount of revenue generated from California operations ($811 million of $4.371 billion total revenues), the number of employees in California (2,300 of 11,230 total full-time employees), and the performance of core executive functions in states other than California.

The district court accepted Hertz's statement of facts as undisputed, but nonetheless remanded the case to state court after analyzing Hertz's citizenship under prevailing Ninth Circuit precedent. Under Ninth Circuit law, courts engage in a two-step analysis to determine the corporation's "principal place of business." They first analyze a corporation's business activity "state by state"; if the amount is "significantly larger" or "substantially predominates" in one state, that state is the corporation's principal place of business. If the amount of business activity is not significantly larger or substantially predominant in one state, then courts conclude that the corporation's "nerve center" — "the place where the majority of its executive and administrative functions are performed" — was the principal place of business.

From the order remanding the case to state court, Hertz appealed to the Ninth Circuit. Although remand orders are generally "not reviewable on appeal," 28 U.S.C. § 1447(d), the Class Action Fairness Act of 2005 permits appeal of orders granting or denying motions to remand class actions. *See* 28 U.S.C. § 1453(c)(1) ("a court of appeals may accept an appeal from an order of a district court granting or denying a motion to remand a class action to the State court from which it was removed if application is made to the court of appeals not less than seven days after entry of the order"). The Ninth Circuit affirmed.

But the Supreme Court granted Hertz's petition for writ of certiorari, vacated the Ninth Circuit's judgment, and remanded the case to give the plaintiffs "a fair opportunity to litigate their case in light of [the Court's] holding."130 S. Ct. at 1195.

Opinion and Reasoning

In rejecting the various complicated and often tortured approaches Circuits had taken in determining "principal places of business," the Court pulled no punches, characterizing the approaches as "doomed to failure":

> This complexity may reflect an unmediated judicial effort to apply the statutory phrase "principal place of business" in light of the general purpose of diversity jurisdiction, *i.e.*, an effort to find the State where a corporation is least likely to suffer out-of-state prejudice when it is sued in a local court. But, if so, that task seems doomed to failure. After all, the relevant purposive concern — prejudice against an out-of-state party — will often depend upon factors that courts cannot easily measure, for example, a corporation's image, its history, and its advertising, while the factors that courts can more easily measure, for example, its office or plant location, its sales, its employment, or the nature of the goods or services it supplies, will sometimes bear no more than a distant relation to the likelihood of prejudice. At the same time, this approach is at war with administrative simplicity. And it has failed to achieve a nationally uniform interpretation of federal law, an unfortunate consequence in a federal legal system.

130 S. Ct. at 1192 (citation omitted).

In place of the splintered approaches employed by the Circuits, the Court sought "to find a single, more uniform interpretation of the statutory phrase." *Id.* Adopting the "nerve center" test, according to the Court, accomplished that objective:

> We conclude that "principal place of business" is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's activities. It is the place that Courts of Appeals have called the corporation's 'nerve center.' And in practice it should normally be the place where the corporation maintains its headquarters — provided that the headquarters is the actual center of direction, control, and coordination, *i.e.*, the "nerve center," and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion).

Id.

continued on page 4

John Sear, a member of this newsletter's Board of Editors, is a partner in the Minneapolis, MN, office of Bowman and Brooke, LLP. He has a diverse product liability defense practice.

Corporate Citizenship

continued from page 3

Better But Imperfect

Three considerations convinced the Court that the test "is superior to other possibilities." *Id*.

First, the "nerve center" test comports with the statutory language, which connotes a single principal place of business within a state. The state itself is not the principal place of business. By contrast, the approach taken by the Ninth Circuit and others would result in California citizenship for virtually every national retailer simply because their business activities reflect California's larger population. Federal jurisdiction, in the Court's view, should not depend upon a state's population.

Second, the "nerve center" test promotes administrative simplicity by eliminating much of the litigation caused by application of complicated citizenship tests. According to the Court, complicated tests "produce appeals and reversals, encourage gamesmanship, and, again, diminish the likelihood that results and settlements will reflect a claim's legal and factual merits." *Id*. at 1193. The simpler "nerve center" test is comparatively easier to apply and offers greater predictability for all litigants.

Finally, the "nerve center" test comports with the legislative history of § 1332. The Judicial Conference of the United States initially proposed in 1951 a "numerical test" akin to the Ninth Circuit's test, but later rejected that test in favor of the "nerve center" test that Congress ultimately embraced in 1958.

While finding that the "nerve center" test offers benefits other tests do not, the Court acknowledged that the test is imperfect and may still lead to "hard cases." For example, according to the Court, "in this era of telecommuting, some corporations may divide their command and coordinating functions among officers who work at several different locations, perhaps communicating over the Internet." 130 S. Ct. at 1194. The "nerve center" test, however, will point in a single direction, towards the center of overall direction, control, and coordination." *Id*.

Likewise, the "nerve center" test may produce results that run counter to the underlying rationale of diversity jurisdiction — minimizing prejudice against defendants who are not citizens of the forum state. If, for example, the corporation's publicly visible activities occur in New Jersey but its control and coordination take place in New York, the corporation could not remove a case filed in New Jersey state court, even though it may experience less prejudice there compared to New York. *Id*. The Court recognized such anomalies could arise, but accepted them "in view of the necessity of having a clearer rule." *Id*. As the Court explained, "Accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system." *Id*.

Strategies for Corporate Defendants

A corporate defendant hoping to remove a case from state court may maximize the benefits of the "nerve center" test by pursuing some simple strategies. A defendant should affirmatively allege in its notice of removal that the corporation's headquarters is its principal place of business. A defendant should allege in its notice of removal that the headquarters is its "nerve center" and "the actual center of direction, control, and coordination" of the corporation's business. A defendant should consistently assert in removal notices and other jurisdictional papers that the headquarters, and nowhere else, is the principal place of business, and ensure consistency between those papers and corporate records regarding the actual center of direction, control, and coordination of the corporation's business — inconsistency can lead to costly disputes and unfavorable consequences for the corporate defendant sued in unfavorable venues.

Conclusion

Hertz Corp. benefits corporate defendants in product liability litigation because it prevents pro-plaintiff federal judges from finding non-diversity of citizenship simply because a corporation has a significant presence in a particular state but headquarters in another one. Under *Hertz Corp.*, therefore, a corporation's headquarters presumptively will be its "nerve center" and, hence, its principal place of business for purposes of determining diversity of citizenship. Corporate defendants can maximize the benefits of *Hertz Corp.* through careful, consistent jurisdictional pleading and ensuring consistency between legal papers and corporate records.

—❖—

Duty to Warn

continued from page 2

Facing defeat in Washington, plaintiffs' lawyers then tried to export their novel theory to California, where it was also rejected by four out of the five intermediate appellate courts that considered the issue. *See Taylor v. Elliott Turbomachinery Co., Inc.*, 171 Cal. App. 4th 564 (1st Dist. 2009), review denied (Cal. June 10, 2009); *Hall v. Warren Pumps, LLC*, 2010 WL 528489 (Cal. App. 2d Dist. Div. 2 Feb. 16, 2010) (unpublished), review granted (May 12, 2010); *Merrill v. Leslie Controls, Inc.*, 179 Cal. App. 4th 262 (2d Dist. Div. 3 2009), review granted and opinion superseded, 224 P.3d 919 (Cal. 2010); *Walton v. William Powell Co.*, 183 Cal. App. 4th 1470 (2d Dist. Div. 4), review granted and opinion superseded, 232 P.3d 1201 (Cal. 2010).

Other courts around the country have rejected similar claims. For example, the U.S. Court of Appeals for the Sixth Circuit has found that a pump manufacturer could not have caused a merchant seaman's illness from exposure to insulation used on the pumps or the replacement gaskets that were supplied by third parties. *See Lindstrom v. A-C Prod. Liab. Trust*, 424 F.3d 488 (6th Cir. 2005). Federal and state courts have also found that vehicle manufacturers are liable only for defective components incorporated into their own finished products; they have no duty to warn of dangers involved

continued on page 8